HONG KONG

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP 2/	154.2	173.0	169.4
Real GDP Growth (pct)	4.6	5.3	-5.0
GDP by Sector:			
Agriculture	0.2	N/A	N/A
Manufacturing	10.7	N/A	N/A
Services	123.4	N/A	N/A
Government	13.5	15.4	N/A
Per Capita GDP (US$)	24,434	26,601	26,302
Labor Force (000s)	3,094	3,216	3,312
Unemployment Rate (pct)	2.8	2.2	5.2
Money and Prices (annual percentage growth):			
Money Supply (M2) 3/	10.9	8.4	8.0
Consumer Price Inflation (pct)	6.0	5.7	2.2
Exchange Rate(HK$/US$)			
Official	7.73	7.74	7.75
Balance of Payments and Trade:			
Total Exports FOB 4/	180.8	188.1	192.8
Exports to U.S. 5/	9.9	10.3	11.2
Total Imports CIF	198.9	210.9	214.1
Imports from U.S. 5/	14.0	15.1	13.2
Trade Balance	-18.1	-22.8	-21.3
Balance with U.S. 5/	-4.1	-4.8	-1.9
External Public Debt	0	0	0
Fiscal Balance/GDP (pct) 6/	1.8	0.8	-2.3
Current Account Balance/GDP (pct)	-1.4	-3.5	-1.5
Debt Service Payments/GDP (pct)	0	0	0

Gold and Foreign Exchange Reserves (end of period) 7/	63.8	92.8	88.4
Aid from U.S.	0	0	0
Aid from All Other Sources	0	0	0

1/ Estimates based on available monthly data in August 1998.

2/ Expenditure-based GDP estimates.

3/ Money supply of Hong Kong Dollars and foreign currencies.

4/ Of which domestic exports (as opposed to re-exports) constituted 15.2 percent (1996), 14.5 percent (1997) and 14.0 percent (1998 estimate based on data through August).

5/ Source: U.S. Department of Commerce and U.S. Census Bureau; exports FAS, imports customs basis; 1998 figures are estimates based on data available through August 1998. Hong Kong merchandise trade includes substantial re-exports (mainly from China) to the United States, which are not included in these figures.

6/ As of Q2 1998.

7/ As of September 1998; the Land Fund was included in the foreign exchange reserves effective July 1, 1997.

Source: Census and Statistics Department.

1. General Policy Framework

Since becoming a Special Administrative Region of the People's Republic of China on July 1, 1997, Hong Kong has continued to manage its financial and economic affairs, to use its own currency, and to participate independently in international economic organizations and agreements.

The Hong Kong Government pursues economic policies of noninterference in commercial decisions, low and predictable taxation, government spending increases within the bounds of real economic growth, competition subject to transparent laws (albeit without antitrust legislation) and consistent application of the rule of law. With few exceptions, the government allows market forces to set wages and prices, and does not restrict foreign capital or investment. It does not impose export performance or local content requirements, and allows free repatriation of profits. Hong Kong is a duty-free port, with few barriers to trade in goods and services.

The government regularly runs budget surpluses, and has amassed large fiscal reserves (though it will run a deficit in 1998). The corporate profits tax is 16.5 percent, and personal income is taxed at a maximum rate of 15 percent. Property is taxed; interest, royalties, dividends, capital gains and sales are not. Government spending has grown from approximately 14 percent of GDP in the mid 1980s to about 19 percent by the early 1990s.

Because monetary policy is tied to maintaining the nominal exchange rate linked to the U.S. Dollar, Hong Kong's monetary aggregates have effectively been demand determined. The Hong Kong Monetary Authority, responding to market pressures, occasionally adjusts liquidity through interest rate changes and intervention in the foreign exchange and money markets.

Financial contagion spreading through the region reached Hong Kong with major downturns in October 1997 and January 1998. The government's response has varied. For example, the government made wide-ranging but modest accommodations in its February 1998 budget announcement, though the steady decline of property prices (and fears for the banking sector) led the government to take steps in June to slow property's descent. In August, it intervened in the stock, futures, and currency markets (spending about $15 billion) to defend itself from market manipulators, arguing the move was a one-time divergence from Hong Kong's usual adherence to non-interventionist, market-oriented policies.

2. Exchange Rate Policies

The Hong Kong Dollar is linked to the U.S. Dollar at an exchange rate of HK$7.8 = US$1.00. The link was established in 1983 to encourage stability and investor confidence in the run-up to Hong Kong's reversion to Chinese sovereignty in 1997. PRC officials have supported Hong Kong's policy of maintaining the link.

There are no multiple exchange rates and no foreign exchange controls of any sort. Under the linked exchange rate, the overall exchange value of the Hong Kong Dollar is influenced predominantly by the movement of the U.S. Dollar against other major currencies. The price competitiveness of U.S. exports is affected in part by the value of the U.S. Dollar in relation to third country currencies.

3. Structural Policies

There has been no major change in Hong Kong's free market approach to economics. The government does not have pricing policies, except for in a few still-regulated sectors such as telecommunications. Even in those areas it is pursuing sector-by-sector liberalization. Hong Kong’s personal and corporate tax rates remain low, and it does not impose import or export taxes. Over the past three years, Hong Kong has completed its deregulation of interest rates covering almost 99 percent of deposits, removing interest rate caps for deposits of seven days or more. Consumption taxes on tobacco, alcoholic beverages, and some fuels probably restrict demand for some U.S. exports. Hong Kong generally adheres to international product standards.

Hong Kong's lack of antitrust laws has allowed monopolies or cartels -- some of which are government-regulated -- to dominate certain sectors of the economy. These monopolies/cartels do not necessarily discriminate against U.S. goods or services, but they can use their market position to block effective competition.

4. Debt Management Policies

The Hong Kong Government has minuscule public debt. Repeated budget surpluses have meant the government has not had to borrow. To promote the development of Hong Kong's debt market, the government in March 1990 launched an exchange fund bills program with the issuance of 91-day bills. Maturities have gradually been extended. Five-year notes were issued in October 1993, extending maturities beyond Hong Kong's reversion to Chinese sovereignty, followed by 7-year notes in late 1995 and 10-year notes in 1996. Under the Sino-British agreed minute on financing the new airport and related railway, total borrowing for these projects cannot exceed US$2.95 billion, and such borrowing "will not need to be guaranteed or repaid by the government." Liability for repayment will rest with the two statutory bodies: the Mass Transit Railway Corporation and the future Airport Authority. In March 1997, the Hong Kong Mortgage Corporation was set up to promote the development of the secondary mortgage market. The Corporation is 100 percent owned by the government through the Exchange Fund. The Corporation purchases residential mortgage loans for its retained portfolio in the first phase, followed by packaging mortgages into mortgage-backed securities for sale in the second phase.

Hong Kong does not receive bilateral or multilateral assistance.

5. Significant Barriers to U.S. Exports

Hong Kong is a member of the World Trade Organization, but does not belong to the WTO's plurilateral agreement on civil aircraft. As noted above, Hong Kong is a duty-free port with no quotas or dumping laws, and few barriers to the import of U.S. goods.

Hong Kong requires import licenses for textiles, rice, meats, plants, and livestock. The stated rationale for most license requirements is to ensure that health standards are met. The requirements do not have a major impact on U.S. exports.

There are several barriers to entry in the services sector:

-- In 1998, the Hong Kong Government announced it would open the international voice telecommunications sector to full competition. The government is still considering whether to issue more licenses in the local fixed telecommunications sector, now limited to four companies. Hong Kong eliminated a regulation that required foreign broadcasters to use the Hong Kong Telecom International satellite uplink rather than their own uplink. It also has promised comprehensive liberalization of the broadcasting regime.

-- A new bilateral civil aviation agreement gives U.S. air carriers important new rights. However, the agreement does not permit code sharing or allow U.S. carriers new fifth freedom passenger rights to carry passengers beyond Hong Kong. These factors will limit expansion of U.S. passenger carriers in the Hong Kong market.

-- Foreign law firms are barred from hiring local lawyers to advise clients on Hong Kong law, even though Hong Kong firms can hire foreign lawyers to advise clients on foreign law. Foreign law firms can become "local law firms" and hire Hong Kong attorneys, but they must do so on a 1:1 ratio with foreign lawyers.

-- Foreign banks established after 1978 are permitted to maintain only one branch (automated teller machines meet the definition of a branch). Since 1994, these banks have been allowed to open a regional and a branch office at separate sites. Foreign banks can acquire local banks that have unlimited branching rights.

6. Export Subsidies Policies

The Hong Kong Government neither protects nor directly subsidizes manufacturers. It does not offer exporters preferential financing, special tax or duty exemptions on imported inputs, resource discounts, or discounted exchange rates.

The Trade Development Council, a quasi-governmental statutory organization, engages in export promotion activities and promotes Hong Kong as a hub for trade services. The Hong Kong Export Credit and Insurance Corporation provides insurance protection to exporters.

7. Protection of U.S. Intellectual Property

Hong Kong is a member of the WTO. In addition, the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention on Industrial Property, and the Universal Copyright Convention (Geneva, Paris) apply to Hong Kong by virtue of China's membership. Hong Kong passed a new Copyright Law in June 1997. Enforcement of copyright and trademarks, however, remains a problem.

Copyrights: Sale of pirated products at retail shopping arcades is widespread. The United States has urged the government at senior levels to crack down on this retail trade, and on the distributors and wholesalers behind them. Hong Kong has responded by increasing enforcement manpower in the customs agency and by conducting more aggressive raids at the retail level. Recent raids, using confiscatory powers in the new Copyright Bill, have largely closed down some of the most notorious retail arcades and dispersed this illicit trade. Pirated goods nevertheless remain available at numerous shops throughout the territory. The judiciary has begun to increase sentences and fines on infringers, but there is still no effective deterrent to piracy. End-user software piracy and unauthorized dealer hard-disk loading remain significant problems for the business software industry. In 1998, Hong Kong approved a new Prevention of Copyright Piracy Ordinance that provides enforcement agencies with new tools with which to control illicit production of optical discs. The copyright industry believes the new law, if aggressively enforced, should enable Hong Kong to reduce illicit production, which exploded in 1997.

Trademarks: Sale of counterfeit items, particularly handbags and apparel, is widespread in Hong Kong's outdoor markets. Customs officials have conducted numerous raids, but these actions have had little impact on the overall availability of counterfeit goods.

New Technologies: Computer chip manufacturers say Hong Kong remains a major center for chip re-marking, but acknowledge that Hong Kong Customs has seized a number of shipments of illicit chips.

There are no reliable figures on the total losses to U.S. firms from piracy in and through Hong Kong. The Business Software Alliance estimated in early 1997 that 62 percent of the business software sold in Hong Kong was pirated; it estimates the level of piracy is higher for non-business software. The U.S. music industry estimates that 20 percent of the recorded music sold in Hong Kong is pirated.

8. Workers Rights

a. The Right of Association: Local law provides for right of association and the right of workers to establish and join organizations of their own choosing. Trade unions must be registered under the Trade Unions Ordinance. The basic precondition for registration is a minimum of seven persons who serve in the same occupation. The government does not discourage or impede the formation of unions

Workers who allege antiunion discrimination have the right to have their cases heard by the Labor Relations Tribunal. Violation of antiunion discrimination provisions is a criminal offense. Although there is no legislative prohibition of strikes, in practice, most workers must sign employment contracts that state that walking off the job is a breach of contract and can lead to summary dismissal.

b. The Right to Organize and Bargain Collectively: In June 1997, the Legislative Council passed three laws that greatly expanded the collective bargaining powers of Hong Kong workers, protected them from summary dismissal for union activity, and permitted union activity on company premises and time. However, the Provisional Legislature repealed these ordinances, removing workers' new statutory protection against summary dismissal for union activity. New legislation passed in October 1997 permits the cross-industry affiliation of labor union federations and confederations, and allows free association with overseas trade unions (although notification of the Labor Department within one month of affiliation is required), but removes the legal stipulation of trade unions' right to engage employers in collective bargaining and bans the use of union funds for political purposes. Collective bargaining is not widely practiced.

c. Prohibition of Forced or Compulsory Labor: Compulsory labor is prohibited under the Bill of Rights Ordinance. While this legislation does not specifically prohibit forced or bonded labor by children, there are no reports of such practices in Hong Kong.

d. Minimum Age for Employment of Children: The "Employment of Children" Regulations prohibit employment of children under age 15 in any industrial establishment. Children ages 13 and 14 may be employed in certain non-industrial establishments, subject to conditions aimed at ensuring a minimum of 9 years of education and protecting their safety, health, and welfare. In 1997, there were nine convictions for violations of the Employment of Children Regulations.

e. Acceptable Conditions of Work: Aside from a small number of trades and industries in which a uniform wage structure exists, wage levels are customarily fixed by individual agreement between employer and employee and are determined by supply and demand. Some employers provide workers with various kinds of allowances, free medical treatment and free subsidized transport. There is no statutory minimum wage except for foreign domestic workers ($500 per month). To comply with the Sex Discrimination Ordinance, provisions in the Women and Young Persons (Industry) Regulations that had prohibited women from joining dangerous industrial trades and limited their working hours were dropped. Work hours for people aged 15 to 17 in the manufacturing sector remain limited to 8 per day and 48 per week between 6 a.m. and 11 p.m. Overtime is prohibited for all persons under the age of 18 in industrial establishments. Employment in dangerous trades is prohibited for youths, except 16 and 17 year old males.

The Labor Inspectorate conducts workplace inspections to enforce compliance with these and health and safety regulations. Worker safety and health has improved, due in part to the transfer of many manufacturing jobs to factories in the mainland, but serious problems remain, particularly in the construction industry. In 1997, a total of 62,800 occupational accidents (43,300 of which are classified as industrial accidents) were reported, of which 58 were fatal. Employers are required under the Employee's Compensation Ordinance to report any injuries sustained by their employees in work-related accidents.

f. Rights in Sectors with U.S. Investment: U.S. direct investment in manufacturing is concentrated in the electronics and electrical products industries. Aside from hazards common to such operations, working conditions do not differ materially from those in other sectors of the economy. Relative labor market tightness and high job turnover have spurred continuing improvements in working conditions as employers compete for available workers.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		624
Total Manufacturing		2755
Food & Kindred Products	2	
Chemicals & Allied Products	309	
Primary & Fabricated Metals	353	
Industrial Machinery and Equipment	205	
Electric & Electronic Equipment	1,132	
Transportation Equipment	41	
Other Manufacturing	713	
Wholesale Trade		5237
Banking		1,859
Finance/Insurance/Real Estate		3,049
Services		1,155
Other Industries		4,387
TOTAL ALL INDUSTRIES		19,065

Source: U.S. Department of Commerce, Bureau of Economic Analysis.